Corporate Governance and Strategic CSR Practices Influence on Credibility of Sustainability Report

"The more talk, the less truth; the wise measure their words"

~Proverb 10:19 (Msg)~

By

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TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURES

ABSTRAK

Pelaporan Kelestarian adalah isu perniagaan semasa di dalam perbincangan tentant akauntabiliti semasa. Pernialaian kritis terhadap amalan pelaporan yang sedia ada adalah penting untuk meningkatkan kualiti pelaporan kelestarian dari sudut kredibiliti dalam memenuhi jangkaan pelbagai pihak berkepentingan. Kajian ini melihat kepada kredibiliti pelaporan kelestarian yang disediakan oleh 113 organisasi di negara-negara rantau Asia Pasifik. Berdasarkan sorotan kerja semasa, beberapa pembolehbah iaitu saiz lembaga pengarah, kebebasan lembaga pengarah, nisbah jantina dalam lembaga pengarah, organisasi visi dan misi yang bersepadu dengan konsep CSR, kewujudan jawatankuasa CSR dan kerjasama dengan NGO telah dipilih dan pengaruh mereka pada kredibiliti pelaporan kelestarian diuji secara empirikal.

Berdasarkan analisis kandungan, hasil process penilaian menunjukkan bahawa amalan strategik CSR memainkan peranan utama dalam kredibiliti laporan tersebut. Kajian ini berakhir dengan cadangan untuk memperbaiki amalan laporan yang sedia ada dan memberi cadangan untuk penyelidikan selanjutnya.

Perkataan utama:

kredibiliti laporan kelestarian; analisis kandungan; teori kesahihan; pandangan perdasarkan sumber; tadbir-urus koporat; amalan strategik CSR.

ABSTRACT

Sustainability reporting is a topical business issue in current accountability age. A critical evaluation of existing disclosure practices is an essential to enhance the sustainability reporting quality in terms of credibility in meeting the expectation from wide-range stakeholders. This study investigates the sustainability report credibility issued by 113 organizations across twelve countries in Asia-Pacific region. Based on the extent literature, a number of variables, that is to say size of board of directors, independence of board of directors, gender proportion of board of directors, organization vision and mission integrated with CSR value, existence of CSR committee and collaboration with NGO were selected and their influence on sustainability report credibility was tested empirically.

Based on content analysis, the outcome of the evaluation process suggests that strategic CSR practices play major role in credibility of sustainability report. The study ends with recommendations to improve the existing reporting practices and suggest areas for further research.

Key words:

Sustainability report credibility; content analysis; legitimacy theory; resource-based view; corporate governance; strategic CSR practices

CHAPTER 1

INTRODUCTION

1.1 Introduction

The shock headline "Howlers and omissions exposed in the world of corporate social responsibility" appeared in the Guardian dated 24th November 2011 certainly make a splash. The article reveals that the examination of more than 4,000 corporate social responsibility report survey by a team at Leeds University found "irrelevant data, unsubstantiated claims, gaps in data and inaccurate figures" (Jowit, 2011). Surprisingly, this is not the first finding!

In the last two decades, companies are increasingly preparing sustainability report (Ackers, 2009; Deegan & Blomquist, 2000; *KPMG International Survey of Corporate Responsibility Reporting 2008*, 2008). Indicatively, over 33,000 such reports were available in Corporateregister.com as of 2011, which acts as an online database to store and publish non-financial reporting. This improvement is a noteworthy, not just level of reporting but the quality of a report. While the number of companies producing sustainability report is increasing globally, the quality of the reporting has been doubted.

Sustainability report is viewed as part of an organization's communication platform, which is desired to demonstrate the reporting organization's accountability to its stakeholders since the reporting process open up the organization to scrutiny of its management systems. Thus, a credible sustainability report is an essential! Realizing the importance of a credible sustainability report, this research seeks to explore influencing factors of a credible sustainability report, especially corporate internal contextual factors such as governance mechanisms and strategic corporate social responsibility, CSR[1] practices.

This chapter serves as an introduction to this study. There are eight sections in this chapter, the first three sections introduce the background of the study, discuss the problems, and define the objectives of this study. This chapter also consists of research objectives, research questions and significance of this study. The final section provides guidance in the organization of the remaining chapter.

1.2 Background of Study

1.2.1 Sustainability Report and its Development

Current business is operating in a challenging and dynamic environment. The sudden collapse of the giant organization Enron in the USA in 2001 and followed by a number of US companies reporting financial difficulties led to a global crisis of confidence towards corporate governance (Duff, 2009). At the same time, most of the organizations were surprised by public responses to issues they had never thought previously. For examples, worldwide, high profile media campaign against Shell's plan for disposal of Brent Spar ("Brent Spar's long saga ", 1998); Boycott on slavery and child based industry followed by the multi-billion sportswear company admitted that it "blew it" by using child labor in the production of soccer balls in Pakistan ("Nike shoes and Child Labor in Pakistan," 2002); the phenomena of "socially

[1] Ethical, economic, environmental, and social impacts and issues that concern the private sector. There are many different terms used to capture this concept, including sustainability, corporate social responsibility, corporate citizenship, environmental social and governance, and others (*KPMG International Survey of Corporate Responsibility Reporting 2008*, 2008)

responsible investment" where the first social stock exchange in Asia; Impact Investment Exchange Asia to be set up in year 2012 to bring together investors with socially impactful interest ("First social stock exchange in Asia to be set up by early next year," 2011). All these business complexities reveal that we are now in the midst of a global transformation with increased demand on a corporation to perform as a good citizen.

One of the most important aspects of this transformation is the critical importance of Corporate Social Responsibility, CSR. CSR is a concept whereby companies integrate social and environmental dimensions into their business strategies and interaction with their stakeholders[2] on a voluntary basis (CEC & Communities, 2001). They are expected to act beyond sustaining a viable financial return to their shareholders by accountable for their stakeholders' wider scope of interest.

Responding positively to emerge stakeholders' interests and expectations, more corporate gear up to improve their working mechanisms, including act ahead of regulation by deploying voluntary codes. In this regard, Non-financial reporting is seen as an important platform to demonstrate transparency, accountability and effective governance (Subramaniam, Hodge, & Ratnatunga, 2006).

Sustainability reporting is one of the voluntary and non-financial reporting. The term "sustainability report" used interchangeable with various social and environment reporting such as corporate responsibility reporting, social and environment reporting, triple bottom line reporting and corporate environmental reporting. It is premised on

[2] Stakeholders are those who affect or are affected by the organization's goal. This includes groups that have a stake in the organization's operation (E. Freeman & Liedtka, 1997).

the notion of sustainable development that refers to both present and future generations having resources available for their enjoyments (Brundtland & Khalid, 1987). Sustainability report, therefore, needs to cover not only the long-term impact of the business activities on the environment and society, but it should demonstrate their commitment in mitigating this negative impact. Organization, therefore, should behave in socially responsible manner and to embrace the notion of managing resources for the well-being of current and future generation.

Sustainability report discloses economic, environmental and social performance. It is not only a voluntarily disclosure, but also an integral element of a communication process (Yussri, Zain, & Darus, 2010), where organization demonstrates their accountability to their stakeholders. Similarly, it provides an opportunity for the stakeholders to identify whether their concerns have been taken into account.

The rationale of voluntary adoption is driven by numerous and complex reasons (Spence & Gray, 2007). Miles et al., (2002) suggested four factors motivate organizations to undertake sustainability reporting: These factors in ascending order of importance are, peer pressure and benchmarking activities; government pressure, stakeholder pressure and pressure from the city. However, a number of benefits arise once the organization has started the voluntary disclosure. For example, risk reduction; increase brand value and increased staff moral. Therefore, the continuous disclosure is driven by proactive and active reasons.

The rising trend of sustainability reporting has been prominently visible through numerous reports (*CR Reporting Awards'10: Global Winners & Reporting Trends*, 2010; *KPMG International Survey of Corporate Responsibility Reporting 2008*, 2008) and empirical studies (Adnan, Staden, & Hay, 2010; C Deegan, Cooper, & Shelly, 2006; O'Dwyer, Unerman, & Bradley, 2005). An international survey of corporate responsibility reporting performed by KPMG in 2008 indicates that approximately 80 percent of the largest 250 companies listed on the Fortune Global 500 worldwide, G250, issued reports while the number of G250 that issue stand alone reports has been increased from 52 percent to 79 percent, an astounding jump over as compare to 2005. Companies in United Kingdom and Japan scored the top rate in corporate responsibility reporting over the last decade. Despite this development, there is scarce academic research in Asian-Pacific region except Australia where social and environment disclosure is widely adopted, see in (Carey & Tanewski, 2000; Deegan & Blomquist, 2000; Deegan & Rankin, 1996; Hodge, Subramaniam, & Stewart, 2009; Kent & Chan, 2003).

As sustainability reporting widely spread in the recent years, sustainability reporting quality has not been universally acclaimed given its challenge in providing accurate data, transparent information, and tendencies towards managerial ism at the expense of accountability to stakeholders (Belal, 2002). For example, Owen et al., (2000)argue, “Accountability and transparency are of reduced importance when compared to management advantage”. They raise a concern that corporate management has taken control of the reporting processes, with the result that information is collected and disseminated only if it is bringing a positive image to corporate, rather than move towards true transparency and accountability to stakeholders. Further explanation for disclosure of information was discussed by Karamanou & Vafeas (2005). They suggest that managers have the incentive to withhold information in order to hinder the market's ability to monitor their performance. In a similar vein, the judges in Ceres ACCA North American Awards[3] 2008 observed that the overall report in Northern still lack of time bound commitments and lack of short-term goals paired with longer-term goals, particularly in certain sustainability issues (*Report of the Judges: Ceres ACCA North American Awards for sustainability reporting 2008*, 2008). Apparently, trust towards organizations continues to be low in relation to its broader sense of responsibility towards society and the environment. Evidence suggests that the information in sustainability reporting is rarely used by management or stakeholders to make inform judgment and action; the acid test of credible and useful communication (AccountAbility, 2003).

Ironically, increased credibility is a pre-requisite for more effective sustainability reporting. There are numerous literatures attempt to address this issue by exploring in different dimensions. For example, organization internal factors (C.A. Adams, 2002; Ricart, Rodríguez, & Sánchez, 2004), culture and governance structure (Adnan et al., 2010), intra industry imitation (Aerts, Cormier, & Magnan, 2006), managerial capture (Baker, 2009), stakeholder influence (Deegan & Blomquist, 2000; Elijido-Ten, Kloot, & Clarkson, 2010) and assurance statement (Owen & O'Dwyer, 2004).

There were some researchers examined the relationship between organization's internal factors and disclosure practices over the years. C. A. Adams(2002) highlights a few 'internal contextual factors' that play a role in influencing reporting. These factors are related to attitudes of organizational members and organization's internal

[3] An award recognizing excellence in sustainability reporting in North American region given out by Ceres and Association of Chartered Certified Accountants, ACCA

processes such as governance, organization structure and department involve in reporting process (C.A. Adams, 2002).

Previous literature also documented that corporate governance influences on corporate disclosure, see in (Adnan et al., 2010; Cerbioni & Parbonetti, 2007; Ricart et al., 2004) positively or negatively is greatly depending on the country of origin (Kamla, 2007). This argument is further described by some studies, which revealed that the number of Board meeting and number of independent non-executive directors has a positive relationship with voluntary disclosures respectively (Donnelly & Mulcahy, 2008; Huafang & Jianguo, 2007; Kent & Stewart, 2008).

In a similar vein, strategic CSR practices influence disclosure practices in different ways. As pointed out by Ullman (1985), the level of a CSR disclosure is determined by organization's strategic posture toward CSR activities, stakeholder power and organization's past and current economic performance. For example, the present of environmental committee tends to increase greenhouse-gas, GHG [4] emission information disclosure (Adnan et al., 2010). Likewise, the role played by stakeholder engagement in reporting is supported by summarized as *" The quality of the reporting is intimately linked to the quality of stakeholder engagement, which preceded and is part of the report" (Thomson & Bebbington, 2005).*

Therefore, this research intends to present evidence on the significant influence of corporate governance and strategic CSR practices towards credibility of sustainability

[4] GHG is one of the several gases that absorb long wave radiation and trap heat in atmosphere.

report. This investigation explores the potential determinants of sustainability report quality in terms of credibility, for which the prior literature gave some guidelines.

1.3 Problem Statement

There has been an unprecedented wave of growth of voluntarily sustainability performance disclosure under the name of sustainability report over the last decade. This sustainability report was born as a tool to support the internal achievement of organization as well as a response to the increasing demand of organization accountability from stakeholders. This accountability can be stood as proof of demonstrating credible and verified information.

However, current practice of the sustainability report has been badly criticized as they failed the expectation from stakeholders. *"Stakeholders want to be sure that the report presents a fair picture, and that it is actually more than just a public relations instrument" (International Annual Review, 2006).* Apparently, trust towards the corporate continues to be low in relation to its responsibility and impact of practices towards societal and environmental (AccountAbility, 2003).

What is the main reason for sustainability report fails the expectation from stakeholders? Why it fails as a credible report and ultimately, fails to demonstrate corporate accountability? Recent years, stakeholders raise their concern for the quality of sustainability report given its great challenge in providing accurate data, transparent information, and tendencies towards managerial ism at the expense of accountability to stakeholders that the company is committed for.

Ironically, practice of voluntary disclosure has been evolving rapidly and resulting in a wider gap in literature especially in Asia-Pacific region where voluntarily reporting is still at its infant stage. For example, even though evidence provides consensus on the importance of size and industry in CSR reporting(Belal, 2008; Owen, 2008), research evidence is still inconclusive on the contextual and general factors influencing sustainability report such as corporate governance, corporate culture, adoption of environmental certification, environmental performance and, etc (C.A. Adams & Nongnooch, 2000; Archambault & Archambault, 2003; R. M. Haniffa & Cooke, 2005; Sumiani, Haslinda, & Lehman, 2007).

Thus, this study intends to fill up the gap by examine the influence of governance mechanisms and strategic CSR practices towards sustainability report credibility issued by companies in Asia-Pacific region.

1.4 Research Questions

To achieve the above objectives, this study attempts to answer the following questions:

(a) What is the level of sustainability report credibility produced by organizations in Asia-Pacific region?

(b) What is the relationship between the corporate governance mechanisms [Board size, board independence and board gender proportion] and the credibility of sustainability report?

(c) What is the relationship between the strategic CSR practices [Vision and Mission with CSR value, Existence of CSR committee and Collaboration with NGO] and the credibility of sustainability report?

1.5 Research Objectives

Therefore, this study attempts to accomplish three main objectives as followed:

(a) To examine the level of sustainability report credibility produced by organizations in Asia-Pacific region.

(b) To examine whether there is a relationship between corporate governance mechanisms [Board size, board independence and board gender proportion] and the credibility of sustainability report?

(c) To examine whether there is a relationship between strategic CSR practices [Vision and Mission with CSR value, Existence of CSR committee and Collaboration with NGO] and the credibility of sustainability report?

1.6 Significant of Study

1.6.1 Theoretical

Along with the evolving of voluntary disclosure, a wider gap in literature is evidence. For example, research evidence is still inconclusive on the contextual and general factors influencing sustainability report. The barrier to strengthen this gap is remaining unexplored. Hence, this study attempts to contribute to the disclosure literature by filling this knowledge gap.

1.6.2 Practical

Recent years have seen a rapid growth in sustainability reporting, particularly by business entities in developed countries followed by numerous literatures in this region. Despite this development, there is scarce academic research in Asian-Pacific region except Australia where social and environment disclosure is widely adopted, see in (Carey & Tanewski, 2000; Deegan & Blomquist, 2000; Deegan & Rankin, 1996; Hodge et al., 2009; Kent & Chan, 2003). As a result, there is limited understanding on practices of the sustainability report in this region. Therefore, this study attempts to develop an Asia-Pacific context guideline in preparing a credible sustainability report.

1.7 Organization of the Remaining Chapter

This study is structured into five chapters. The first chapter provides background and introduction of this study. The second chapter presents the review of the literature, which outlines previous studies undertaken with respect to sustainability report quality and credibility. It is followed by third chapter, which discusses on theoretical framework and hypothesis development. The forth chapter illustrates the data and variables in terms of research design, sample collection, measurement of variables, the method of data analysis and expected outcome. Chapter five analyzes the result of findings, focusing on statistical analysis, descriptive statistic, correlation analysis and regression analysis. Lastly, the sixth chapter presents the overall findings and implications of the research based on the study conducted, limitation of the study as well as a suggestion for future research and conclusion.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter gives an overview of underlying theory, literature on sustainability report quality, credibility and the influential characteristic of disclosure practices.

2.2 Theories

To date, several lines of arguments explain on the disclosure practices. A number theories lend the best application in this literature, such as Agency theory (Jensen & Meckling, 1976), Resource dependence theory (Bebbington, Larrinaga, & Moneva, 2008), Stakeholder theory (Kent & Chan, 2003; Roberts, 1992; Ullmann, 1985) and Legitimacy theory (Deegan, 2002; Kent & Monem, 2008). These theories describe how sustainability reports create pressure on the organization to be more responsible, but each of them differs in terms of the level of refinement in approaching the disclosure issue.

2.2.1 Agency Theory

Agency theory discussed by Jensen & Meckling (1976) laid a framework for linking disclosure behavior to corporate governance by considering both as a mechanism of accountability.

Agency literature argues that managers will choose a set of decision to maximize their own utility in the presence of information asymmetries (Cerbioni & Parbonetti, 2007). The theory suggests a potential conflict, which arisen from the principle's inability to prepare costless perfect contract, particularly in monitoring manager, reduces a firm's value. Conflict between shareholders and managers occur due to various reasons, including the different managerial approach and risk management.

They also propose that agency cost to the relationship between shareholders and management can be reduced through disclosure (Jensen & Meckling, 1976). Williamson (1984), cited in Cerbioni & Parbonetti (2007) discuss that the information asymmetries in the transaction can be mitigated by disclosure that provides greater transparency. As such, company with high agency cost will try to increase governance activities and voluntary disclosure in order to reduce agency cost.

Cerbioni & Parbonetti (2007) argue that the main element determining the relationship between corporate governance and disclosure is whether the impact of the internal governance mechanisms on disclosure is complement or substitute to each other. In case of complementary, agency theory predicts a positive relationship between corporate governance and disclosure in which; adoption of more governance mechanisms or effective governance mechanism will strengthen the organization's internal control hence reduce the opportunities to information asymmetric.

Agency theory was adopted in some disclosure literature. For example, Barako et al., (2006) investigated the extent to which corporate governance attribute, ownership structure and company characteristic influence voluntary disclosure in a developing country namely Kenyan. They found that audit committee is a significant factor associated with the level of voluntary disclosure. Meanwhile, R. M. Haniffa & Cooke (2005) pursued the importance of various corporate governance and cultural characteristics as possible determinants of voluntary disclosure. The result indicates significant associations between two corporate governance variables: chair that is a non-executive director and domination of family members on boards. Ness & Mirza (1991) used agency theory to test for a relationship between environmental- related disclosure and oil industry. The result found is consistent with agency theory, which dictates that social and environmental related information is disclosed to increase the welfare of management.

2.2.2 Resources Dependence Theory

Resource dependence theory gains great attention after the first introduction by Pfeffer & Salancik in the book *The external control of organization: A resource dependence perspective, 1978 (Davis & Cobb, 2010).* Resources Dependence Theory study on how the external resources of an organization affect the operation and behavior of an organization. It based on the notion that environments are the source of scarce resources, and organizations are dependent on these resources for survival. The emphasis on external resources and careful articulation of both strategic and tactical management in an organization, is a hallmark of resource dependence theory (Davis & Cobb, 2010). It has implications regarding the optimal divisional structure of organization, production of strategies, contract structure, recruitment of Board members and employee, external organizations links and some other aspects of organizational strategy (El-Nadi, 2011).

There are previous studies, which adopt the resource dependence theory in examining disclosure. Aerts et al., (2006)suggested in their research, organization's imitation of another firm's Corporate Environmental Reporting, CER within its industry is determined by the tendency of other organizations within the industry to imitate one another. They comment that high-quality reporting is more likely to generate these mimetic behaviors than low quality report. Meanwhile, Resources dependence theory was borrowed in Nikolaeva & Bicho (2011) research while looking into the driving factors of GRI adoption in an organization in the framework of institutional theory. Resource dependence theory is applicable to this research objective base on the notion that to a certain extent, firms are dependent of stakeholders; as such good reputations ensure better access to resources.

Pfeffer and Salancik identify three factors that influence the dependence organization on particular resources; the overall importance of the resource an organization is rested on the scarcity of the resources and competition between organizations for control of the resources. It argues that in order to reduce the impact of this environmental uncertainty on organizational performance, it is necessary for an organization to develop a sustain relationship with their external environment (El-Nadi, 2011).

Resource dependence states that, relationship with its external environment is one of the essential factors of successful business. Effective management of an organization's relationship with its external environment requires management to consider the concern of various stakeholders. Sustainability reporting is typically a prominent place within a firm's disclosure strategy since social and environmental issues are the key concerns to a wide range of stakeholders such as regulators, financing industry or employee. As in the context of this study, the stakeholder's or to be specific, the users of sustainability report demand for a credible report is being characterized as issue to be addressed in maintaining an external organization link. Thus, this study focuses on the strategic practices that underlie the improvement of sustainability report credibility.

2.2.3 Stakeholder Theory

Stakeholder theory was brought into the mainstream of management since it was proposed as a strategic management of organizations in the late twentieth century (R. E. Freeman, 1984). Stakeholder theory explains the relationship between stakeholder and organizational managers. In the traditional view, stockholders and shareholders are the owners of an organization, and the organization has a biding fiduciary duty to increase their value. However, Stakeholder theory broadens the scope of shareholder to stakeholder by defining stakeholders as "any group or individual who is affected by or can affect the achievement of an organization's objectives" (R. E. Freeman & McVea, 2001). This is including creditors, suppliers, employees, public interest groups, government bodies, rules makers and society. According to Stakeholder theory, the major objective of a firm is to attain the capability to balance the various demands of stakeholders (Roberts, 1992).

From this model, Ullmann extended the concept by studying corporate social responsibility activities in a stakeholder framework. This framework is used for predicting the level of corporate social responsibility activity as well as level of information disclosure(Roberts, 1992). According to Ullmann (1985), almost all correlations between social and economic performance and social disclosure can be sufficiently explained through three dimensions; 1) Stakeholders power in terms of degree of control over corporate's resources. A positive relationship between stakeholder power, social performance and social disclosure is expected if social responsibility activities are perceived as a strategy to manage a relationship of stakeholders. 2) Corporate strategic posture towards corporate social responsibility activities. It describes the mode of response of a corporate towards the social demands. Therefore, an active strategic posture is expected to develop detail programs and prepare finer disclosures to address stakeholder influences. 3) Corporate economic performance where the finer the economic performance of a company; the greater corporate social activities and disclosures (Elijido-Ten, 2004).

Stakeholder theory is widely adopted in research examining stakeholder influences in the social and environmental disclosure given that stakeholder engagement continues guiding influence in this arena. Elijido-Ten et al., (2010) uses stakeholder theory to explain the determinants of environmental disclosure in Malaysia. The result suggests that the main determinants in preparing environmental disclosures are the government power to sanction companies and top management environmental concern. Stakeholder theory was adopted by Kent & Chan (2003), for explaining the quantity and quality of voluntary corporate environmental disclosures in Australian listed companies' annual report. The study suggests the needs to mandate environmental information given that less than half the samples prepare environmental information and those disclosing generally is not informative.

In summary, Stakeholder theory uncovers importance of stakeholder management, particularly in a social fabric that is demanding on environments and social performance, corporate governance and creditable disclosure.

2.2.4 Resource- based View

Resource-based view emphasizes on costly-to-copy attributes of an organization to deliver sustainable competitive advantages when the valuable resources are managed in such that competitor cannot imitate the outcome. According to this theory, the organization's ability to attain and maintain the profitability is primarily lied on its ability to gain and defend the advantageous position in underlying resources (Conner, 1991). Resource-base view defines a resource, is something an organization poses while a capability is something that an organization can perform, which creates a competitive barrier.

According to resource-based view, competitive advantage can be attained only when a resource is valuable, rare, imperfect inimitable and non-substitutable. Valuable resources enable an organization to employ a value creation strategy that increases customer willingness to pay, reduce its cost and outperform their competitors. Rareness is uniqueness of resources, which enable an organization to avoid direct competition in the market. Inimitable resource is a resource, which is impossible to perfectly imitate or copy because of relationship of these resources, and competitive advantages are ambiguous or socially complex. A non-substitutable resource is not substitutable by other alternative resources (Hart, 1995).

Resource-based view lays a foundation for refining the analysis of how corporate social policy influences the sustainable management. This is because it focuses on performance as key outcome and it's works on adopting resource based recognizes intangible concepts (J. B. Barney, 1986), such as reputation and corporate culture (J. B. Barney, 1986). It recognizes the attribute associated with past experiences; organizational culture and competences are the essential factors for an organization to outperform their competitors. For example, in a conceptual study looking at industrial organization economies, Conner (1991)suggests that "an in-house team is likely to produce technical knowledge, skill, or routine that fits better with the firm's current activities".

In its later state, Hart (1995) expanded this theory to include the constraints imposed and opportunities offered by environment, where the organization is operated. In this theory, he demonstrated a concept, which link the goal of securing and enhancing the social legitimacy with competitive advantage. This concept is lies behind the principle that societal demands are part of the external environment facing an organization to develop unique resources in moving towards sustainability (Russo & Fouts, 1997). This is true, particularly true when external stakeholders are demanding organizations play a role of a good citizen.

The resource-based view provides insights into how responsible management contributes to the firm's internal and external benefit. Branco and Rodrigues (2006) explained that CSR activities and reporting of these activities play a critical role in creating intangible resources. Internally, a positive reputation creates harmony-working environment where employees are motivated, committed, and a high level of moral and loyalty to firm. Externally, CSR initiatives and CSR activity's report will establish positive brand equity, which are as essential intangible resources. For example, in a study examining factors influencing social responsibility disclosure practices of samples listed on Portuguese Stock Exchange, by using a theoretical framework which combines resources-based theory and legitimacy theory, Branco & Rodrigues (2008) suggests that companies with higher visibility exhibit greater concern to establish brand equity through a social responsibility report.

2.2.5 Legitimacy Theory

Both Legitimacy theory and stakeholder theory are two theories derived from wider political economy perspective and used in explanation of the motivational aspects of social disclosure (Laan, 2004).

Legitimacy theory postulates that a corporation must act with congruence with society's value and norms to exit continually (Dowling & Pfeffer, 1975). *"Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions." (Suchman, 1995).*

Legitimacy is associated with the reaction of an observer to the organization as they see it. Audience accepts and more likely to supply resources to organization that is desirable while disapprove of the continuity of organization, which deviate from social norms and value (Suchman, 1995). This is further explained by Neu et al., (1998) where a company pursues legitimacy because it *"helps to ensure the continued inflow of capital, labor and customers necessary for viability.. It also* *forestalls regulatory activities by the state that might occur in the absence of legitimacy... and pre-empts product boycotts or other disruptive actions by external parties... By mitigating these potential problems, organizational legitimacy provides managers with a degree of autonomy to decide how and where business will be conducted".*

Obviously, audience's reactions can be greatly influenced by effective communication. It is argued that sustainability report is a platform to communicate with interested members of society, which ultimately affect on how an audience acts towards them and how well they understand them. As such, sustainability report acts as a logical medium of influencing society's perception on their operation and legitimizes their ongoing existence. More specifically, Legitimacy theory interprets social disclosure as part of the process of addressing the cognitive forces that constrain and empower organization.

Legitimacy literature, Wilmshurst & Frost (2000) analyzed the relationship between factors identified as influential to corporate management and the level of environmental disclosure within the annual report. Chief Finance Officers, CFOs of selected Australian companies were invited to rate the determinants in the decision to disclose environmental information. The environmental disclosure within annual report of responded were then reviewed and analyzed. While this study interpreted legitimation from the quantity of information disclosed rather than from an assessment of the quality of the disclosure, the result provides a certain level of confidence in supporting legitimacy theory as an explanatory link between the influential factors and environmental disclosure practices.

A study conducted by O'Donovan (2000) supports this view by saying that observation the tactic; the tone nature and intention of disclosure are greatly differing depending on the purpose of a corporate response; whether to gain, maintain or repair legitimacy.

Consider that a theory, which can espouse the practices of sustainability reporting, would have great explanatory power in assessing the reporting quality. It is proposed that, a theoretical framework based on the legitimacy theory, and resources-based view establish a platform to provide a specific explanation on what factors to drive an organization to provide credible sustainability report. According to Branco & Rodrigues (2008), a framework combining legitimacy theory and resource-based perspective assume managers increasingly need to consider social responsibility disclosure as a tool to improve social and environmental conduct in a particular field because this influences the organization's reputation; a critical external resource that determines the successfulness of an organization.

2.3 Sustainability Reporting

The accounting, auditing and reporting are essential elements in business activities. However, it is no longer restricted to financial reporting. It was expanded to other areas, environmental and social performance in this case. The engagement of reporting is clarified in various ways, Figure 1 shown the social and environmental accounting/ auditing activities base on the distinction between internal and external participants. Social and environmental reports fall into quadrant 4. It is when the organization is systematically preparing and communicating social and environmental information to its stakeholder where the most visible form of social and environmental auditing arises (Gray, 2000).

	Accounting/auditing by Internal participants	Accounting/auditing by External participants
Report for the internal participants	**1. Private information from 'management audits'** Ex1. A company undertakes an environmental audit to identify the forms and classes of wastes produced by its processes; Ex2. A company details its internal audit department to assess how well the overseas subsidiaries comply with the corporate mission statement on employment conditions;	**2. Private information from external sources** Ex1. A company may either (a) have an external consultant come in to undertake a specific investigation into the forms and classes of wastes or (b) be subject to external audit by the environmental agency into its disposal of wastes; Ex2. External consultants are engaged to hold confidential dialogues with employees and other powerful stakeholders over whether the company is a 'good' employer;
Report for the external participants	**4. Public self-reporting by the organisation** Ex1. A company publishes an environmental report detailing the types and classes of wastes, their treatment and trends; Ex2. A company produces detailed reports about numbers and conditions of employees working in 'developing' countries.	**3. The public external social audits** Ex1. A local activist group become anxious about the wastes produced by the organisation and undertake their own investigation-seeking maximum publicity for its activities; Ex2. International Labor Organization releases report about health of employees in counties in which the company operates.

Figure 1: The social and environmental accounting/ auditing activities base on the distinction between internal and external participants. Source: Gray,(2000).

2.3.1 Emerges of Sustainability Reporting.

Social and environmental reporting was still in infant stage; however, it is showing a steadily growth since it first publication in 1989 (Kolk, 2004). With greater awareness of broad social and environmental issues incorporated into corporate decision-making process, corporate environmental report evolves to corporate social responsibility report and further down to corporate sustainability report (Park, 2004).From year 1992 to 1998, approximately 90% of such reports fell into either one of these two categories namely Environment or Environmental, Health and Safety, EHS. A few years later, a new category was introduced termed "sustainability or corporate responsibility" reports. By 2010, approximately 75% of the non-financial reports issued by organizations were termed as sustainability report or corporate responsibility report (*CR Reporting Awards: 2011 Global Winners & Reporting*